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VALIDITY OF PROVISION FOR PAYMENT OF ATTORNEY'S FEES FOR COLLECTION IN NOTE.

Is the provision in a promissory note for the payment of attorney's fees for collection in addition to interest at the legal rate valid and enforcible, and what is the effect of such provision upon the negotiability of the note?

As to the effect of the provision upon the negotiability of the note the cases all hold that it is in no way impaired. This is the rule even in those states in which it is held that the provision is void and inoperative. See Boozer *v.* Anderson, 42 Ark. 167. This holding seems beyond question, for the provision for attorney's fees is independent of the body of the note and can fall without destroying other parts. The Negotiable Instruments Law protects the negotiability of the note.

To the validity of the provision itself, three objections have been made and all have found judicial sanction in the different states. The first objection is that the provision is usurious. The question raised has been decided both ways in Virginia. The second objection is that the provision is a penalty. This has also been held both ways in Virginia. The third objection is that the provision violates public policy. This has been decided in the negative in Virginia. It may then be said that the Supreme Court of Appeals of Virginia has ruled five different ways on the question of the validity of such a provision.

IS THE PROVISION USURIOUS?

The first case is that of Pollard *v.* Baylor, 4 Hen. & Munf. 223, which involved the validity of a deed of trust given to secure certain payments in tobacco to a London merchant with commission. There was also a provision for the payment of an additional sum in case of nonshipment. It was held that the transaction was usurious and that the deed of trust was void. This case was decided in 1809. Just ten years later another action of ejectment was brought on the same deed of trust and the

court in Pollard *v.* Baylor, 6 Munf. 433, overruled the prior case, saying, "We are all of opinion, that a penalty inserted in a contract, from which a party may deliver himself, does not make the contract usurious; and that the law is the same where it is in the power of the party, by a compliance with his contract, to convert it into a compensation for services rendered. We are all also of opinion, that the question whether a contract is usurious or not, is to be decided with reference to the time when it was entered into; that a contract legal at that time, cannot be made usurious by subsequent events; and that an usurious agreement is one to pay, originally, a greater premium than the law allows. It would indeed be an anomaly, if, the next day after the execution of this contract, it had been adjudged to be usurious, and had afterwards been rendered otherwise by the compliance of the appellee with his contract." This case is cited in Selby *v.* Morgan, 3 Leigh 588, another usury case but of a different state of facts.

The next case is that of Toole *v.* Stephens, 4 Leigh 581, and involves certain facts which distinguish it from the other cases. A bank had recovered a judgment against a debtor, who asked indulgence, which was granted upon the debtor agreeing to give security and in addition to pay the attorney of the bank all the costs of the suits and the commissions which the bank had agreed to pay the attorney for collecting the debt. This agreement was held usurious.

Then came the leading case of Campbell *v.* Shields, 6 Leigh 517. A debtor owing a debt presently due, agreed to give the creditor his bond for it payable at a future day, and to add to the debt, and insert in the bond, a sum equal to 5 per cent, on the debt, to cover commission which the creditor might be compelled to pay an agent for collection; and the bond was given accordingly, for the aggregate including the commission; with a verbal agreement, that if the debtor should pay the debt punctually, he should be exempted from payment of the sum inserted in the bond for commission for collection: in debt on the bond, and issue joined on the plea of usury. Held, the contract was not usurious, since the debtor might by punctual payment of the debt, relieve himself from payment of the sum he contracted to

pay for commission. The case, also, decided that whether the provision was a device to evade the usury laws is for the jury to determine. This case is still the law of usury in Virginia. The case of Rixey *v.* Pearre, 89 Va. 113, while upon a similar state of facts decided a different point of law, and the case of Oglesby *v.* Bank, 114 Va. 663, though not in point approved Campbell *v.* Shields. With the last mentioned case a review of the cases in this state ends as far as the question of usury is concerned.

The Negotiable Instruments Law, Art. 3, § 21, provides that the sum payable is a sum certain although it is to be paid with costs of collection or an attorney's fee in case payment shall not be made at maturity. How does this provision affect the usury laws? It may be answered, not at all, except in so far as the negotiability of the note is concerned. It in no way gives validity to the provision but merely protects the note in its negotiable character. As held in Bank *v.* Poteet, 74 W. Va. 511, 82 S. E. 332, the Negotiable Instruments Law does not legalize contracts expressly condemned and declared void by the statutes of the state. The rule of Campbell *v.* Shields is not affected by the Negotiable Instruments Law, except as to the question of negotiability.

The cases from other states holding the provision usurious turn upon the facts involved or are under statutes differing from those of Virginia.

There is one very recent case, however, which should be mentioned, that is Bank *v.* Poteet, 74 W. Va. 511. It is appropriate here to merely mention this case and not discuss it fully; for, while it does hold the provision usurious, the opinion is really based upon a clear violation of other statutory provisions as to costs and attorney's fees. It is not an authority in point on the question of usury. Then, too, there is a strong dissenting opinion concurred in by two justices which is more than apt to cause litigants to contest the rule of the majority. As far as the pure question of usury in the provision is concerned, it may be said that the law of West Virginia is not satisfactorily settled by the case of Bank *v.* Poteet.

A clear and convincing case holding the provision free from usury is Parkham *v.* Pullman, 5 Coldw. (Tenn.) 497. At page

501, it is said: "The contract of the debtor to pay the attorney's commission in case of suit upon default of payment of the debt, for the prescribed time, adds nothing to the amount of interest to be paid to the creditor. If the debtor pays the ten per cent, interest stipulated, and also pays the attorney's commissions, the creditor has received no more than the ten per cent, interest. If he does not pay the attorney's commissions, the creditor receives, to that extent, less than the ten per cent interest. At page 504, it is said: "Our conclusion then, is, that the stipulation to pay attorney's commissions, is not, of itself, usurious. The creditor may well contract that the debtor shall pay lawful interest, and also pay the attorney's commissions, in case of suit upon default of payment of the debt. If both are paid by the debtor, the creditor gets no more than lawful interest. If the contract be fully executed as to both these clauses, and the money actually paid by the debtor, the creditor has no usury." And it was said in Telford *v.* Garrels, 132 Ill. 550, 555, citing McIntire *v.* Yates, 104 Ill. 491: "The trust deed contains a provision that, in case of foreclosure, reasonable attorney's and solicitor's fees may be paid out of the proceeds of sale, and the service shows that the amount allowed is a reasonable fee for the services rendered. Under such circumstances the decree was not erroneous in providing for the payment of such amount."

Of course, the provision like any other agreements may be a device to avoid the usury laws. A device of any kind, the purpose of which is to enable the creditor to obtain for the use of money, or forbearance of the debt, more than the lawful rate of interest, is usurious. "It is said, however, that the five per centum in this case is by the agreement of the parties, to be added to the seven per cent, not as interest, but as costs, agreed upon as such, for collection, by the parties. Now, it seems to us to be of little consequence, in this case, what this five per cent may be called, but the inquiry is, what is the thing itself? However it may be disguised, it is very clear to us it is a mere shift or device by which twelve per cent is retained, as interest, upon this loan, and in this view of the case can not be enforced. This court have decided that under the laws of Ohio, but six per cent interest is recoverable, though the parties contract for more

or higher rates." State *v.* Taylor, 10 Ohio 378, 380. Whether the provision is usurious or not, depends mainly upon the intent of the parties. If the design is to enable the creditor to receive more than the lawful rate of interest, the provision is usurious; but, if merely to defray expense of collection caused by the debtor's default and which can be relieved against by prompt payment, it is not usurious.

The conclusion here reached is that the provision is not usurious, with the exception noted, and that such conclusion as an abstract rule of law is not in defiance of the cases which have, under peculiar circumstances, held in favor of its usurious nature.

Is the Provision a Penalty?

The next question is is the provision a penalty? By Bouvier a penalty is defined to be, a clause in an agreement, by which the obligor agrees to pay a certain sum of money if he shall fail to fulfill the contract contained in another cause of the same agreement, and is distinguished from liquidated damages by the intent of the parties.

The debtor may default and the creditor be put to expense to protect himself; this expense may very appropriately involve the payment of an attorney.

In the case of Rixey *v.* Pearre, 89 Va. 113, it was held that an agreement in a note for the payment of ten per cent on the face of the note for attorney's fees for collection is a penalty and not enforcible. While the decision of this case happens to be logical and supported by authority, it is poorly considered and the sole authority cited is that of Bullock *v.* Taylor, 39 Mich. 139. As stated above this case does not, as to usury, overrule Campbell *v.* Shields, 6 Leigh 517, but it is unfortunate that the latter case is not considered and the distinction between the provisions being penal and its being usurious is not made. The case of Rixey *v.* Pearre was followed in Fields *v.* Fields, 105 Va. 714.

In Oglesby *v.* Bank, 114 Va. 663, these cases were by dictum overruled. The opinion reads:

"Two Virginia cases are cited to support the contention that the stipulation in question is a penalty and contrary to the policy of this State, and, therefore, not enforceable, viz.: Rixey *v.* Pearre

Bros. & Co., 89 Va. 113, and Fields *v.* Fields, 105 Va. 714. It is specially noteworthy that the agreements in both these cases antedated the enactment of the negotiable instrument law in March, 1898. The former case followed, without discussion, a Michigan decision, Bullock *v.* Taylor, 39 Mich. 137, 33 Am. St. Rep. 356, and in the latter it is said: 'This court has held that an agreement in a note to pay attorney's fees for collection is a penalty and not enforceable.' Citing the first-named case. In Stratton *v.* Mutual Assurance Society, 6 Rand. (27 Va.) 28, the court upheld the by-law of a society which declared that members who, by failing to pay, rendered it necessary to coerce payment of premiums by legal proceedings, should indemnify the society for expenses incurred in the employment of collectors by payment of seven and one-half per cent. on such premium and interest. It was said that the exaction was neither usury nor a penalty, citing Greenhow *v.* Buck, 5 Munf. (19 Va.) 263." This quotation is dictum, for what the court decided is that a provision in a negotiable note for the payment of a fee of ten per cent for the collection by an attorney is valid under the laws of New York and not contrary to the public policy of this state, and will be enforced in this state when an action is brought in the courts of this state on a New York contract containing such a stipulation.

These cases all involve the provision for payment of a fee of ten per cent of the face value of the note—the amount usually charged by attorneys for collection and regularly approved by the courts. This amount is the actual expense to which the creditor is put in case of necessity for employment of an attorney. In other words, it is his damage.

There is very weighty authority from other states for the theory that the provision is a penalty. These cases are as a rule based upon the principle that an agreement for the payment of a greater in default of payment of a lesser sum is a penalty. In the case of Boozier *v.* Anderson, 42 Ark. 167, it is stated: "To us it appears clear, even to demonstration, that they are agreements for a penalty. The obligor agrees to pay a certain sum of money if he shall fail to perform the contract contained in another clause of the same instrument. Now courts of equity abhor penalties and forfeitures. So far from lending their aid

actively to enforce them, they are inclined to relieve against them, when it can be done consistently with their rules. Compensation and not forfeiture is their aim. Accordingly they consider that when a debtor pays the debt, with interest for its detention and costs of suit, he ought not to be mulcted in a further sum. Whenever the injury is susceptible of definite admeasurement, as it is in all cases where the breach consists in the non-payment of money, the parties will not be allowed to stipulate for a greater amount, whether in the form of a penalty or of liquidated damages." This case hints at the solution of this question in the distinction it recognizes between compensation and forfeiture. For that reason while the express holding is that the provision is invalid it leaves an opening for the creditor to claim compensation. It may be construed to permit a provision for attorney's fees in an amount to which the creditor is actually and necessarily required to expend by the debtor's exercise of his option to default.

In Bank *v.* Poteet, 74 W. Va. 511, it is held a stipulation in a negotiable promissory note for the payment of "five per cent collection fees" on the principal thereof, and in addition thereto "and $10.00 attorney fee in addition to the attorney's fee taxed or allowed by law" is, void and unenforcible. In the opinion it is said, "Viewed as a contract of indemnity, the stipulation fails on the same principle. It is indemnity against what a debtor, unable or unwilling to pay, has a legal right to do, avail himself of the delay in payment, accorded him by law, subjecting himself to the incidental punishment inflicted in the form of costs and fees prescribed, and recoverable. This legal, though not moral, right in the debtor precludes the existence of any consideration for the contract as one of indemnity, and the agreements amounts to no more than one to bear the burden imposed by the law upon the person in whose favor it is made, an agreement to give something for nothing." With all due respect to the reasoning of the court it does not seem to be a sound principle that a debtor has the legal right to default. This the law condemns and opens its courts to the injured creditor. The better theory is that he has no legal right to breach his contract and throw the creditor into litigation. The law favors the party who performs, not who breaches, his

contract. It does not encourage the breach of a contract nor is it lenient or sympathetic to the defaulter.

An idea pervading the reasoning of the court is that the provision is without consideration. It is appropriate to quote the opinion at some length. "The agreement to pay costs and attorneys' fees is obviously not an agreement to pay for any service to be rendered to the promisor, the maker of the note, for such services are always rendered to and for the promisee, the payee of the note. It is a promise to pay for something done against the promisor and to his material injury. He derives no benefit from it. The detriment to the other party, occasioned by the default in payment, is the only circumstance that could possibly constitute consideration for the promise. In that case, the injury is deprivation of the use of the money and the compensation for that is fixed and limited by the statutes, allowing only the legal rate of interest and the legal costs, including the attorney's fee, prescribed by law. Our statutes limit the interest to 6 per cent, fix the costs in court, and prescribe the amount to be included as an attorney's fee. Nothing more can be obtained by force of law." The quotation mentions and then refutes the detriment to the creditor as a consideration. The refutation is based upon the statutory provisions. Suppose there were no such provisions, how would the court reach its conclusion then? The truth is, while the court speaks of a penalty, what it really decides is the statute law of West Virginia provides for attorney's fees and the parties, being bound by such statute, cannot contract in violation of it. The case then is really little authority on the question of the penal nature of the provision.

The case of Boozier *v.* Anderson, 42 Ark. 167, discussed in this connection is also based on the want of a consideration to support the provision. But the court apparently is not conscious of the fact that a sufficient consideration may consist in a detriment to the creditor as well as a benefit to the debtor.

In conclusion it may be stated that such provision is not necessarily penal, but is of such nature or not according to the intent of the parties, and this is a question of law to be determined by the court from a consideration of the whole instrument. As it may be a device for usury so may it be one for a penalty.

IS THE PROVISION CONTRARY TO PUBLIC POLICY?

The last objection that it is necessary to note is that the provision is contrary to public policy. In all the cases in this state the provision has been questioned but once on this ground and that is in the last case on the subject, Oglesby *v.* Bank, 114 Va. 663. This case arose on a note made in the state of New York. It was held that the provision for the payment of a fee of ten per cent for the collection by an attorney is valid under the laws of New York and not contrary to the public policy of this state, and will be enforced in this state.

The question of public policy was necessarily involved and directly passed upon. The question then is settled in this state. The opinion relies upon the Negotiable Instruments Law, article 3, § 21, providing that the sum payable in a negotiable paper is a sum certain, although it is to be paid with costs of collection or an attorney's fee in case payment shall not be made at maturity. In its reliance upon this provision, the court is certainly justified, for while it is the purpose of the legislature merely to protect the negotiability of the papers, the provision is clear evidence of legislative policy on the subject, which is public policy.

In Bank *v.* Poteet, 74 W. Va. 511, it is held that a promise in a negotiable promissory note for the payment of "five per cent collection fees" on the principal thereof, and in addition thereto "and $10.00 attorney fee in addition to the attorney's fee taxed or allowed by law" is, in West Virginia, forbidden by the policy of the law and void and unenforceable. The court said: "For reasons of public policy, the legislature has, in effect, declared that the lender or creditor shall take the risk of expense of collection in excess of the allowance it has made by way of indemnity or reimbursement." As appears from the quotation the conclusion of the court is reached by statutory construction. The court construes the provision for costs and attorney's fees to impliedly prohibit the parties from contracting for other than the statutory fees. The opinion reads: "Having specified what may be recovered, whether the common law would have permitted more or not, by its prescription of rules, the legislature has impliedly negatived any supposed right to obtain anything in addition thereto. The detriment to the payee or holder, result-

ing from default in payment to the payee or holder, resulting from default in payment, is compensated as fully as the legislature intended it to be, by the costs and fees prescribed by the statute, wherefore there can be no consideration for the promise, even in the sense of detriment." Raleigh County Bank *v.* Poteet, 74 W. Va. 511, 515.

The court, also, decided that the provision is not affected by the Negotiable Instruments Law. The headnote reads the negotiable instruments law, does not legalize contracts expressly condemned and declared void by the statutes of this state, nor those forbidden by the policy of its laws. What is decided is that the provision violates the positive statute law of the states, but the court does not go fully to the extent of holding that it violates public policy which extends to the protection of natural as well as legal justice, liberty, morals and rights.

In State *v.* Taylor, 10 Ohio 378 a provision to pay five per cent as collection fees in addition to the legal interest for money loaned was held against public policy and void. "Is it such a contract as public policy should excite? What may be supposed as the natural result to the community from the execution of this agreement? It would be the condition of future loans, at banks, that the borrower should pay the expenses of collection, and, perhaps, the tax thereon. The brokers in this state would hold a general jubilee; and as their sense of morality and law usually expands with their hopes of gain, in proportion to the borrower's necessity they would find, probably, additional items of costs, as the means of a legalized extortion upon their loans. In our opinion, such agreements are against the public policy of the country, and ought not to be enforced in courts of justice. They have, by this court, on the circuit, been denied to be obligatory, and further reflection confirms us in the correctness of such opinion. The absence of adjudicated cases in the reports, either English or American, show these agreements are of modern invention, having their origin in the improvements of the age."

The term "public policy" is very broad and the courts have a habit of broadening it even more to fit certain contracts, but it seems that they have gone beyond the principle of public policy in applying it in the present case. This for two reasons, first,

the provision for attorney's fees in no way tends to the general public injury or concern which public policy may be invoked to protect; and second, this is a rule of the Law Merchant which is based upon customs and statutes, under which the provision is valid or invalid, to be determined upon whether it is or is not sanctioned by custom or statute. Again public policy is properly a subject for the legislature and not for the courts. It is really a question of expediency and whether or not negotiable paper should be burdened with a provision for attorney's fees is one for the commercial world to decide and seek legislation upon. This article will not go into it, but will simply conclude by stating, with due respect to opinion to the contrary, that the provision is not inhibited by public policy, in the absence of some statutory expression evidencing a policy against it.

In this state it has been held a negotiable note made in Virginia but payable in New York, and discounted there, is a New York contract, and its validity, when sued on in this state, is to be determined by the laws of New York; a clause in such a note providing for the payment of a fee of ten per cent for collection by an attorney is, like the provisions for the payment of interest and exchange, a mere incident of the principal contract, and to be governed by the same law, although payment is sought to be enforced in Virginia. Oglesby Co. *v.* Bank, 114 Va. 663.

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